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SUBJECT: OUTREACH TO THE MONTERREY PRIVATE SECTOR

REF: MEXICO 5044

¶1. (SBU) To expand our ties to the Monterrey business community, the Consulate has initiated an informal Business Roundtable, i.e., a bimonthly breakfast with selected private sector and industry leaders. At the first session of this roundtable on November 26, we hosted representatives from key American companies, the Group of Ten (the largest Monterrey companies), local chambers of commerce, an economist and a business professor, with the Consulate being represented by the Consul General, Econoff and the Commercial Officer. The participants had a frank discussion of pending issues, such as the impact of the U.S. economy on Mexico, the Mexican IETU flat tax, opportunities for Mexico to move to higher value added industries, and prospects for petroleum sector reform. The Consulate plans to hold Business Roundtables every two months on various business topics. One theme we hope to emphasize in upcoming sessions is how (and to what extent) the current wave of narco-violence in Northern Mexico is impacting both domestic and foreign investment.

¶2. (SBU) Double Taxation. Discussion initially focused on whether the U.S. Treasury would permit American companies to deduct their Mexican IETU tax payments from their American tax obligations (see reftel). Roberto Cavazos, executive director of the Monterrey chapter of the American Chamber of Commerce, warned of significant negative consequences for companies' bottom-line if Mexican tax payments could not be deducted, in particular, the possibility that the 'double taxation' could reduce American investment in Mexico and damage the credibility of the Calderon Administration (This is in line with what we have repeatedly heard concern from various contacts).

¶3. (SBU) Outlook for Mexican/U.S. Economy. The Roundtable participants then discussed the effect of the housing slowdown in the United States and whether it would affect Mexico's economy. The consensus was that Mexican economic growth would be a solid 3%, and Mexico continues to harvest substantial foreign direct investment. However, some focused on a worst-case scenario, i.e., a situation where a drop in the U.S housing market led to a recession - which in turn stunted growth in Mexico. The fear was that if a downturn in the U.S. spilled across the border, this might occur during the critical 2008-2009 period (i.e., prior to congressional and state/local elections) and negatively affect prospects for candidates friendly to President Calderon.

¶4. (SBU) Moving up on the Maquila Chain. The Roundtable also discussed Mexican opportunities to develop higher value added manufacturing such as services and back room operations, the aerospace industry, and increasing the role of Mexican design and engineering in existing manufacturing operations such as the

automotive industry. Consul General noted that some U.S. companies were already taking advantage of the pool of university-trained engineers in Monterrey to outsource their design operations here. Consulate officers stressed the potential for public/private partnerships to promote design and technology clusters.

15. (SBU) Prospects for the Petroleum Sector. Among our Mexican interlocutors, there was a general consensus that PEMEX was in urgent need of reform. There were actually two problems, one CEO observed. First, as many industry analysts had pointed out, proven reserves in the key Cantarell field were dropping. Second, and even more importantly, he continued, was that the GOM was using PEMEX to fund its ongoing current expenditures. This was an unsustainable situation, both for GOM finances and the administration of PEMEX itself. While many agreed that opening up PEMEX to private capital (while retaining GOM control of the company) was a potential solution, everyone concurred that any proposal that smacked of 'privatization' would be politically toxic. The most that our contacts hoped for was some sort of reform 'lite,' akin to what they felt was done in the GOM's recent financial reform.

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